

**BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF KANSAS**



In the Matter of:

MARK R. SCHNEIDER (CRD# 1275330)

Docket No. 13 E 006

KSC No. 2011-5864

OAH No. 13OS0001

Respondent.

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FINAL ORDER

Now this 1st day of May, 2015, this matter comes before the Kansas Securities Commissioner on review of the Initial Order issued by the administrative law judge (ALJ) on Feb 4, 2015. Both parties have petitioned for review of the Initial Order and review has been granted. The Respondent appeared by counsel, Roger N. Walter and the staff of the Office of the Securities Commissioner (the "State") appeared by Nathan Soendker. Both parties declined to submit additional briefing. Therefore, after oral arguments by the parties and a review of the record taken by the Office of Administrative Hearings, the following Final Order is issued:

I. Standard of Review

1. The review of an initial order is governed by K.S.A. 77-527, which states: " Subject to K.S.A. 77-621, and amendments thereto, in reviewing an initial order, the agency head or designee shall exercise all the decision-making power that the agency head or designee would have had to render a final order had the agency head or designee presided over the hearing, except to the extent that the issues subject to review are limited by a provision of law or by the agency head or designee upon notice to all parties. In reviewing findings of fact in initial orders by presiding officers, the agency head shall give due regard to the presiding officer's opportunity to observe the witnesses and to determine the credibility

of witnesses. The agency head shall consider the agency record or such portions of it as have been designated by the parties.”

2. Given the hearing and the testimonial evidence offered to ALJ in this matter, the Commissioner acknowledges the credibility determinations made by the ALJ and gives due regard given his ability to see the testimony presented to him. Conclusions of law are reviewed *de novo*.

II. Findings of Fact

3. The respondent is an investment adviser representative registered in the State of Kansas and associated with Plan Inc., a registered investment adviser. This was a finding made by the ALJ. It was undisputed in the parties’ Petitions for Review. The Commissioner finds it is supported by the record.
4. From 1999 through June 2012, the respondent was registered as a broker-dealer agent associated with Plan Professionals, Limited, a FINRA member firm. This was a finding made by the ALJ. It was undisputed in the parties’ Petitions for Review. The Commissioner finds it is supported by the record.
5. The respondent is a certified financial planner and an enrolled agent with the Internal Revenue Service. This was a finding made by the ALJ. It was undisputed in the parties’ Petitions for Review. The Commissioner finds it is supported by the record.
6. The respondent has passed the following FINRA exams and holds the following license designations: Series 6; Series 7; Series 22; Series 24; Series 27; Series 51; and Series 63. This was a finding made by the ALJ. It was undisputed in the parties’ Petitions for Review. The Commissioner finds it is supported by the record.

7. [REDACTED] and her husband, [REDACTED], were longtime clients of the respondent. In addition to financial advising, the respondent assisted [REDACTED] with business related issues, life insurance and tax returns. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
8. The respondent had discretionary authority over a substantial portion of the [REDACTED] assets. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
9. Prior to his death in January 2010, [REDACTED] handled the all of the family's finances. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
10. At the time of [REDACTED] death, the [REDACTED] assets were conservatively managed by the respondent. The portfolio was comprised primarily of cash, with a limited amount of mutual funds and large cap equities. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
11. At least due in part to the respondent's insistence that [REDACTED] purchase large life insurance policies, [REDACTED] collected approximately \$1.2 million upon [REDACTED] death. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
12. After [REDACTED] death, [REDACTED] still had children in school, was not working, and needed income from her investments to support herself and her family. This was a

finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.

13. [REDACTED] was not a sophisticated investor and relied on the respondent to provide her with professional investment services. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.

14. In May 2010, the respondent generated a financial plan for [REDACTED]. At that time, [REDACTED] investment objective was primarily income production. The respondent determined that [REDACTED] had insufficient assets to provide for her long term income needs and needed to grow her assets. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.

15. Shortly thereafter, the respondent liquidated the positions held in [REDACTED] discretionary accounts and purchased leveraged and inverse Exchange Traded Funds ("Non-Traditional ETFs"). This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.

16. The record shows that the respondent held various leveraged and inverse ETFs positions in [REDACTED] discretionary accounts for periods exceeding one day. Often, positions would be held for over one hundred days. Three positions were held for 182 days. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.

17. According to the respondent, at the time that [REDACTED] held the Non-Traditional ETFs, "the market was very volatile." The respondent exercised his professional judgment in the

purchase and use of Non-Traditional ETFs with Silverman's assets. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.

18. The respondent placed a series of stop-losses on the Non-Traditional ETF positions, designed to exit the position if the losses became too large. However, every time a stop-loss was triggered, the respondent placed a larger one in its place, the largest being a 10% stop-loss. Eventually, the respondent lifted them all together. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
19. At no time did the respondent inform [REDACTED] that he was using Non-Traditional ETFs, the risks associated with such products, that he planned on using them in contravention of how they were designed to be used, or the potential for large losses. This was a finding made by the ALJ. The Commissioner finds it is supported by the record as described in the discussion section below.
20. In prospectuses detailing the attributes and risks associated with the Non-Traditional ETFs, issuers explicitly state that Non-Traditional ETFs do not seek to achieve their investment objectives over a period of time longer than one day. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
21. In 2009, the Financial Industry Regulatory Authority ("FINRA") issued Regulatory Notice 09-31, *"Non-Traditional ETFs,"* which reminded its members that although Non-Traditional ETFs "may be useful in some sophisticated trading strategies, they are highly complex financial instruments," and are "typically are unsuitable for retail investors who

plan to hold them for longer than one trading session, particularly in volatile markets."

This finding was made by the ALJ. It is supported by the record and the quoted language exists in the Notice. (See Petitioner's Exhibit 50-D, p. 2).

22. The respondent testified that he had read Regulatory Notice 09-31 at the time it was released. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
23. Non-Traditional ETFs require special care because of their nature as complex products that are not suitable for the average retail investor. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
24. The respondent testified that there was no difference in the level of care required between Non-Traditional ETFs and other products. This finding was made by the ALJ and the Commissioner finds it is supported by the record. (See Hearing Transcript, p. 48:14-23).
25. The respondent believes the risk from investing in Non-Traditional ETFs came from the market itself, rather than from the product. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
26. Nonetheless, in direct contravention to Regulatory Notice 09-31, the respondent testified that he placed essentially all of his approximately 160 retail clients in Non-Traditional ETFs (including [REDACTED]). The evidence shows that, with respect to a sampling of those clients (including [REDACTED]), he held Non-Traditional ETF positions for periods lasting longer than one day. This was a finding made by the ALJ. The Commissioner

finds it is supported by the record as described in the discussion section below. (*See eg.* Hearing Transcript, p. 75:1-5; 76:11).

27. The Office of the Kansas Securities Commissioner presented expert testimony from Jack Duval ("Duval") that Non-Traditional ETFs are speculative investments and are not generally suitable average retail investors such as [REDACTED]. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
28. Duval testified that speculative investments such as Non-Traditional ETFs are not generally suitable for investors needing income and growth. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
29. According to Duval, an investment adviser representative exercising his discretion in utilizing and holding Non-Traditional ETFs for in a period of longer than one day would constitute a breach of the investment adviser representative's fiduciary duty. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
30. No evidence was presented to show that [REDACTED] was anything other than a retail investor, or that she was in any way atypical so that Non-Traditional ETFs would be a suitable investment and that using them contrary to the prospectuses would be suitable. This was a finding made by the ALJ. It was undisputed in the parties' Petitions for Review. The Commissioner finds it is supported by the record.
31. Ultimately, the respondent's actions cost [REDACTED] \$94,710.60. This was a finding made by the ALJ. The Commissioner finds it is supported by the record.

32. At the hearing, the respondent declined to explain what the constant leverage trap was after answering a question, in the affirmative, from staff for the Office of the Kansas Securities Commissioner, about whether he knew what the term constant leverage trap meant. When directed by the ALJ to answer the question, the respondent changed his answer to "no" rather than comply with the instruction of the ALJ. This was a finding made by the ALJ. The Commissioner finds it is supported by the record as described in the discussion section below. (See Hearing Transcript, p. 114-116:11).
33. Additionally, at the hearing, the respondent appeared arrogant and made no recognition of the fact that he might have been wrong in how he utilized Non-Traditional ETFs. This was a finding made by the ALJ. The Commissioner gives the ALJ due regard in his credibility determination and finds that it is not unreasonable given the record.
34. Finally, at the hearing, Duval presented lucid, well-reasoned, and well-researched testimony. His testimony included discussion of the analysis he had done for this appeal as well as his qualifications. This was a finding made by the ALJ. The Commissioner gives the ALJ due regard in his credibility determination and finds that it is not unreasonable given the record.
35. The respondent claims to have known and understood how Non-Traditional ETFs were to be used. However, the evidence presented demonstrates a total disregard for the accepted wisdom regarding the suitability of Non-Traditional ETFs.
36. The respondent put almost all of his clients, including [REDACTED] into Non-Traditional ETFs despite the fact all were retail investors.
37. Various regulatory notices and advisories indicate that an adviser must be intimately familiar with Non-Traditional ETFs. It is clear from the respondent's testimony, when

taken as a whole, that he: 1) was not nearly as knowledgeable as he should have been regarding the product; 2) disregarded accepted industry practice in how the product was to be used; 3) ignored regulatory guidance; 4) failed to trade the product as intended; 5) failed to monitor the investments appropriately; and 5) lost [REDACTED] a significant sum of money as a result.

II. Conclusions of Law

38. The respondent is accused of multiple violations of K.S.A. 17-12a412(d)(13) and K.A.R. 81-14-5(d)(1). The respondent also stands accused of multiple violations of K.A.R. 81-14-5(c).

39. What constitutes a "dishonest or unethical practice" is defined in K.A.R. 81-14-5.

Subsection (a) of that regulation states: "Dishonest or unethical practices as used in K.S.A. 17-2a412(d)(13) shall include the conduct prohibited in this regulation."

Subsection (d)(1) prohibits an investment adviser representative from recommending an investment to a client without reasonable grounds to believe the recommendation is suitable for the client. Subsection (c) provides that an investment adviser is a fiduciary and is bound to act in the best interests of his client at all times.

40. K.A.R. 81-14-5 defines and sets parameters of what conduct is expected from an adviser.

A plain reading on this regulation does not indicate that only the conduct in subsection (d) constitutes a dishonest or unethical practice. Rather, the entire regulation contains standards to which an adviser is held. Failing to meet those standards or breaking the enumerate prohibitions could constitute a dishonest or unethical practice.

41. As the respondent asserts, this entire case can be reduced to one question. Namely, did the respondent have a reasonable basis to believe the Non-Traditional ETFs were suitable for [REDACTED]? Given the record on review, the Commissioner finds that he did not.
42. Credibility of witnesses is determined by the trier of fact. *Stoskopf v. Stoskopf*, 173 Kan. 244 (1952). Although the Commissioner may disagree with the ALJ's credibility determinations, such disagreements must be fully explained and supported by substantial competent evidence in the record. *Tire Disposal Facilitators, Inc. v. State ex rel. Harder*, 22 Kan. App.2d 491, 492 (1996). Otherwise, due regard shall be given to the ALJ. See K.S.A. 77-621.
43. The ALJ considered the credibility of the respondent and finds it lacking. Not only did the respondent change his answer rather than answer as directed by the ALJ, the respondent's knowledge of investing in general and utilization of good investment advising practices seemed lacking from his answers. The Commissioner does not find competent evidence in the record to disagree with this determination.
44. On the other hand, the ALJ found Mr. Duval to be a very credible witness. His explanations and analysis were easily understood and he was very knowledgeable on the product including all of the potential issues with Non-Traditional ETFs. In contrast to the respondent, Mr. Duval was not evasive or arrogant in his answers. Accordingly, the ALJ accepts Mr. Duval's analysis and findings regarding the respondent's use of Non-Traditional ETFs. The Commissioner does not find competent evidence in the record to disagree with this determination.
45. Here, the respondent failed [REDACTED] in two main ways. First, he used a product that he knew or should have known was unsuitable for her and failed to advise her that he was

doing so. Second, he knowingly disregarded industry guidance and accepted practice and held the product for longer than it was designed.

46. [REDACTED] experienced substantial losses given the respondent's actions.

47. Accordingly, the Commissioner finds there is sufficient evidence to support the respondent's violations of K.S.A. 17-12a412(d)(13), K.A.R. 81-14-5(d)(I), and K.A.R. 81-14-5(c).

III. Discussion

Respondent filed a Petition for Review in this matter in which he objects generally to all material aspects of the ALJ's Initial Order and requests that the Commissioner reverse the material findings and conclusions set forth in the Initial Order. Respondent specifically objects to five main factual and legal determinations of the Initial Order, as follows:

- Respondent argues that the ALJ incorrectly found that FINRA Regulatory Notice 09-31 ("Notice") governed the advisory activities of respondent in this matter and determined that the Notice imposed a categorical prohibition on the use of non-traditional ETFs for retail investors such as [REDACTED] (*see Respondent's Petition for Review*, p. 3-4);
- Respondent argues that the ALJ incorrectly made numerous factual findings impugning Respondent's knowledge and understanding of non-traditional ETFs (*see Respondent's Petition for Review*, p. 4-6);
- Respondent argues that the ALJ incorrectly found that Respondent was unaware of the different level of care required when investing in non-traditional ETFs (*see Respondent's Petition for Review*, p. 6-7);
- Respondent argues that the ALJ incorrectly found that "[a]t no time did the

respondent inform [REDACTED] that he was using non-traditional ETFs, the risks associated with such products, that he planned on using them in contravention of how they were designed to be used, or the potential for large losses” (see *Respondent’s Petition for Review*, p. 7-9);

- Respondent argues that the ALJ’s finding that the Respondent “appeared arrogant and made no recognition of the fact that he might have been wrong in how he utilized Non-Traditional ETFs” (see *Respondent’s Petition for Review*, p. 9);
- Respondent argues that the ALJ’s conclusion that State’s expert, Mr. Duval, was a credible witness was unfounded (see *Respondent’s Petition for Review*, p. 9-11).

The State also filed a Petition for Review in this matter in which State requests that the Commissioner affirm the findings of fact and conclusions of law in the ALJ’s Initial Order and impose specific administrative sanctions in the following amounts:

- Restitution in the amount of \$94,710.60 to [REDACTED];
- A civil penalty of \$25,000 for violations of K.S.A. 17-12a412(d)(13) and K.A.R. 81-14-5(d)(1);
- A civil penalty of \$25,000 for violations of K.S.A. 17-12a412(d)(13) and K.A.R. 81-14-5(c).

After review of the ALJ’s Initial Order and the record in this matter, the Commissioner finds that the ALJ’s factual findings in this matter were based upon substantial, competent evidence. Respondent’s specific contentions are addressed in detail below.

Respondent argues that the ALJ incorrectly found that FINRA Regulatory Notice 09-31 (“Notice”) governed the advisory activities of respondent in this matter and determined that the Notice imposed a categorical prohibition on the use of non-traditional ETFs for retail investors

such as [REDACTED]. However, nowhere in the Initial Order did the ALJ find that FINRA Regulatory Notice 09-31 was a governing document or anything other than regulatory guidance. The Notice did, however, serve as substantial, competent evidence of industry standards regarding the use of non-traditional ETFs and the risks inherent in using such products. The ALJ did not find that the Notice imposed a categorical prohibition on the use of non-traditional ETFs for a certain class of investors but rather that the Respondent's actions and knowledge level, when compared with the recommended actions and requisite knowledge level suggested in FINRA Notice 09-31, demonstrated that the Respondent: "1) was not nearly as knowledgeable as he should have been regarding the product; 2) disregarded accepted industry practice in how the product was to be used; 3) ignored regulatory guidance; 4) failed to trade the product as intended; 5) failed to monitor the investments appropriately; and 5) lost [REDACTED] a significant sum of money as a result."

In sum, the record supports the ALJ's evidentiary findings that the Respondent's disregard of the guidance in FINRA Notice 09-31 factually demonstrated, in part, that the Respondent did not have a reasonable basis to believe the Non-Traditional ETFs were suitable for [REDACTED].

Respondent also argues that the ALJ incorrectly made numerous factual findings impugning Respondent's knowledge and understanding of non-traditional ETFs. A comprehensive review of the record demonstrates that Respondent's use of non-traditional ETFs demonstrated such a severe lack of judgment regarding the nature and appropriate use of such products that the factfinder was left with no other. While the factual record does not read like a multiple choice test, the answers given during demonstrated both a lack of appreciation for the risks inherent both in the use of non-traditional ETFs in general and the use of non-

traditional ETFs in contradiction to the way such products were designed to be used. The Respondent's testimony indicated his unfailing confidence in such complex investment products for not only [REDACTED], but nearly all of his clients, over and against industry advisory guidance. Moreover, Respondent's unorthodox use of the products (i.e. holding the non-traditional ETF positions for more than a day), and his unwillingness or inability to articulate a legitimate reason for his unorthodox approach demonstrates an irrational basis for his suitability determination. While his lack of understanding of terms of art like "constant leverage trap" in questioning does not alone demonstrate a lack of understanding of the products, his inability to articulate a legitimate rationale behind his unorthodox approach over and against clear industry regulatory guidance demonstrates that he had no reasonable basis for concluding that his unorthodox approach, or the products themselves, were suitable for [REDACTED]. This, when coupled with the ALJ's credibility determination as discussed below, provide a factual basis for the legal conclusion that the products at issue were unsuitable for [REDACTED].

The Respondent argues that the ALJ was incorrect in determining that the Respondent was unaware of the different level care required when dealing with the products at issue. Respondent argues that the utmost care was used for *all* the investments he made for his clients and, therefore, the Respondent used the adequate level of care when dealing with leveraged and inverse ETFs. This issue is collateral to a suitability determination in this case but the record provides enough of a basis for the ALJ's determination. The Respondent's semantic distinction does not change the ultimate finding the products at issue were unsuitable for [REDACTED].

The Respondent also takes issue with the ALJ's finding that [REDACTED] was not apprised of the specific risks associated with the products at issue. Given [REDACTED] testimony, this finding is supported by the record. The evidence in this case demonstrates that the products

at issue can produce a loss even if the investor correctly predicts a market direction. These particular risks were not discussed with [REDACTED]. While disclosing such risks and obtaining a client's informed consent to using these products does not necessarily make them suitable, obtaining such a client's consent helps a person in the Respondent's position articulate the reasonable basis for a particular course of action. Here, the Respondent's reasonable basis for a one-size-fits-all overall market hedge strategy through the complex products at issue is lacking in the record. In looking at whether a product is suitable for a particular customer, such as [REDACTED], a dialogue must take place regarding the applicable investment strategy to determine whether the strategy fits with the customer's investment objectives and propensity for risk. While the Respondent used various forms to glean some of this information, the specific risks associated with the products at issue and their intended use required additional disclosures and discussion to determine whether they were truly suitable for [REDACTED]. Given the record, it is clear that they were not.

Finally, the Respondent objects to credibility determinations made by the ALJ regarding Mr. Schneider and Mr. Duval. Due regard is given to those determinations because the ALJ saw the testimony in person and was able to obtain a complete picture of each witness. Given the record, the ALJ's determinations are not unreasonable. The Respondent had an opportunity to clearly articulate his reasonable basis for the investments at issue given their particular risks. Those risks include the possibility for the investments to lose money even if the market went the way he predicted. The ALJ found that the Respondent failed to do this. Part of that finding was attributed to what the ALJ found to be arrogance and an inability to acknowledge the fact that his actions may have been wrong. Given the record, the Commissioner is not in a position to overturn this finding. Likewise, the ALJ's determination regarding Mr. Duval must stand

given the record. The Respondent points to various statements made by Mr. Duval that he believes are inconsistent and takes issue with the research done by Mr. Duval as cursory. The ALJ was in a position to listen to Mr. Duval's entire testimony in the moment and apparently did not feel his statements were contradictory given their context in the entire conversation. Additionally, the Respondent had the opportunity to submit additional evidence and cross-examine Mr. Duval regarding his research. Ultimately, the ALJ viewed Mr. Duval's testimony as credible. Given the record, the Commissioner does not find the ALJ's determination to be unreasonable.

IV. Conclusion

After a review of the record and oral arguments, the Commissioner **AFFIRMS** the Initial Order as discussed herein and finds that Respondent's actions violated K.S.A. 17-12a412(d)(13) K.A.R. 81-14-5(d)(1), and K.A.R. 81-14-5(c).

IV. Order

After being advised in the premises, the Commissioner **HEREBY ORDERS** that:

1. The Initial Order is affirmed as described herein.
2. Restitution is ordered in the amount of \$94,720.60 to [REDACTED]
3. A civil penalty of \$25,000 is assessed for violations of K.S.A. 17-12a412(d)(13), K.A.R. 81-14-5(d)(1), and K.A.R. 81-14-5(c).

IT IS SO ORDERED BY THE COMMISSONER.

Entered at Topeka, Kansas, this 1st day of May, 2015.



[REDACTED]
Joshua A. Ney
Securities Commissioner
State of Kansas

NOTICE:

This decision constitute a final agency action that is subject to judicial review. A Petition for Judicial Review must be filed within 30 days of this Order pursuant to K.S.A. 77-613. The agency officer to receive service of a petition for judicial review on behalf of the Office of the Securities Commissioner is Joshua A Ney, Securities Commissioner, at 109 SW 9th St., Suite 600, Topeka, KS 66612. A party to this action may also Request for Reconsideration within 15 days of this Order pursuant to K.S.A. 77-529 or a Request to Stay the Order pursuant to K.S.A. 77-528. More information about post-hearing remedies can be found in the Securities Administrative Procedure Manual available at <http://ksc.ks.gov/DocumentCenter/View/274>.